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Cotton Rally Peaking as Farms Build Stocks on Record Crop (1)  
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(Adds today's cotton price in seventh paragraph.)

By Debarati Roy, Madelene Pearson and Chris Prentice

March 28 (Bloomberg) -- The rally that drove cotton prices to the highest since America was recovering from the Civil War is ending as farmers from Texas to New South Wales plant record crops and replenish stockpiles for the first time since 2007.

Cotton will drop 51 percent to \$1 a pound by Dec. 31, according to the median in a Bloomberg survey of 14 analysts and traders. Hedge funds are already cutting bets on higher prices by the most in three years. Output may rise 11 percent to 127.5 million bales in the year that starts Aug. 1, three times faster than a 3 percent gain in demand to 120 million bales, the U.S.

Department of Agriculture estimates. One 480-pound bale is enough for 215 pairs of jeans.

"We have had quite a nice run, and I don't see it sustaining," said John Stephenson, who helps manage more than C\$2 billion (\$2 billion) at First Asset Investment Management Inc. in Toronto. "More acreage will be dedicated to cotton, and in a scenario where consumers are facing higher food and fuel prices, clothing will take a back seat."

Cotton rose to \$2.197 on March 7, the highest in 140 years of trading in New York, after flooding in Australia and Pakistan and freezes in China ruined crops. Adidas AG, the second-largest sporting-goods maker, said this month that cotton was a cost threatening margins, and Wal-Mart Stores Inc., the world's biggest retailer, paid more for garments including jeans.

#### Food Costs

Farmers are responding by planting more cotton, which may come at the expense of corn and soybeans, First Asset's Stephenson said. Corn gained 79 percent since July 1 and soybeans climbed 50 percent, driving global food costs to a record, the United Nations estimates. An extra 44 million people were driven into "extreme" poverty since June, according to the World Bank, and riots spread across North Africa and the Middle East, toppling leaders in Egypt and Tunisia.

While March 7 marked the peak, it's much less than in previous decades. In 1973, cotton jumped to the highest in at least 14 years to 99 cents, the equivalent of \$4.92 today, according to a calculator on the website of the Federal Reserve Bank of Minneapolis.

Cotton closed at \$2.0449 on March 25, after surging 178 percent since mid-July, the most among the 24 commodities in the Standard & Poor's GSCI index. The raw-materials gauge climbed 42 percent, the Standard & Poor's 500 Index gained 20 percent and Treasuries lost 0.2 percent, a Bank of America Merrill Lynch index shows. Cotton lost 3.4 percent today to \$1.975 a pound.

## Money Managers

Hedge funds and other money managers cut bets on higher prices by 64 percent from a September peak, the steepest drop since 2008. Their wagers declined for seven consecutive weeks, the longest stretch since at least June 2006, and total 29,185 contracts, U.S. Commodity Futures Trading Commission data show.

One contract equals 50,000 pounds.

Futures anticipate a drop to \$1.2792 by December, according to ICE Futures U.S. data. Costs won't fall to the \$1 predicted in the Bloomberg survey until October 2012, the data show.

Even \$1 would still be 64 percent higher than the 10-year average of 61.16 cents. Stockpiles in warehouses monitored by ICE Futures U.S. plunged 81 percent since June and in October fell to the lowest level since at least August 2002.

"Global plantings are set to expand impressively this year," said Gary Raines, an economist at FCStone Fibers & Textiles in Nashville, Tennessee. "Even if this production overshadows mill demand, the gap may not be enough to rebuild world inventories enough to pull prices down to their long-term average in just one marketing year."

## Extreme Weather

Prices could still rally to \$2.30 by June because supply is so scarce and more "weather problems or other external catastrophes" could mean a high of \$2.90, said John Flanagan, president of Flanagan Trading Corp. in Fuquay-Varina, North Carolina.

Demand is still strengthening. In the year ending July 31, China will use 17.5 million more bales than it grows, the USDA estimates. China's economy will expand 9.5 percent this year, more than three times the growth of the U.S. and the euro zone, according to the median of as many as 68 economists' forecasts compiled by Bloomberg.

While farmers will grow more cotton this year, not all of it may reach global markets. India, the second-biggest producer after China, limited cotton-yarn exports in December because of concern about domestic shortages. It eased some of those restrictions last month.

## Farm Profit

The same surge in prices that is helping boost U.S. farm profit by 20 percent to a record \$94.7 billion is hurting manufacturers, retailers and consumers.

The "headwinds on costings, particularly on cotton out of Asia, will affect everyone," Myron E. Ullman, the chairman and chief executive officer of J.C. Penney Co., the third-biggest U.S. department-store chain, said March 9. Gap Inc., the largest U.S. apparel chain, is facing similar issues, Chairman and CEO Glenn K. Murphy said on a conference call the same day.

Raw materials, labor and transport costs are all creating "a gross margin headwind," Herbert Hainer, CEO of Herzogenaurach, Germany-based Adidas, said on a conference call March 2. Nike Inc., the world's largest sporting-goods firm, began to see the impact in the third quarter, Chief Financial Officer Don Blair said on a call two weeks later.

Wal-Mart, based in Bentonville, Arkansas, already paid more for some cotton garments including jeans, and "we're told that by later

this year, there will be substantially more" increases, William Simon, President and CEO of Wal-Mart U.S., said on a conference call March 10.

#### Textile Makers

Some U.S. textile makers are canceling orders or using more synthetic fibers on concern they won't be able to pass costs to customers, said Cass Johnson, president of the Washington-based National Council of Textile Organizations, which has more than 80 companies as members.

Cotton's share of the global textile market will shrink to about 30 percent by 2020 from about 37 percent as mills switch to synthetics, according to the International Cotton Advisory Committee. The Washington-based group has 43 member countries.

Best Western International Inc., the world's biggest hotel chain by rooms, said it's paying 53 percent more for towels than it did a year ago. Orders for towels and sheets can take as long as two months to fill, compared with two weeks normally, the company said in an e-mailed response to questions.

In the year that begins Aug. 1, global cotton plantings will increase by 7.9 percent to 36 million hectares (89 million acres), the most in 16 years, according to the committee.

#### Biggest Exporter

Production in the U.S., the biggest exporter, will rise 6.6 percent to 19.5 million bales in the next crop year, according to USDA estimates. Indian output may climb to a record, according to Bhadresh Trading Corp., the nation's top exporter. Output in Australia, the fourth-biggest shipper, may also surge to an all-time high, the Australian Bureau of Agricultural & Resource Economics & Sciences forecast March 1.

By the end of the next crop year, in July 2012, global stockpiles may have expanded by 18 percent to 50 million bales, according to the USDA.

"The prices are exaggerated, and the shortage in the market has been overstated," said Christoph Eibl, co-founder of Zug, Switzerland-based Tiberius Group, a fund manager overseeing more than \$2 billion. "The market has been pushed up a lot by speculators and this is not sustainable."

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